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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. ---

UNITED STATES OF AMERICA, PETITIONER

v.

R. F. BALL CONSTRUCTION COMPANY, INC., AND UNITED PACIFIC INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The memorandum decision of the District Court (App., *infra*, p. 15) is reported at 140 F. Supp. 60. The *per curiam* opinion of the Court of Appeals (App., *infra*, p. 14) is reported at 239 F. 2d 384.

JURISDICTION

The judgment of the Court of Appeals (App., *infra*, p. 14) was entered on December 26, 1956. By order of Mr. Justice Black on March 21, 1957, the time for filing a petition for certiorari was extended to April 5, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTIONS PRESENTED

1. Whether the assignee of an unborn account receivable assigned as collateral security for a contingent obligation not even in potential existence at the time of the assignment is a "mortgagee" (or "pledgee") within the meaning of Section 3672 of the Internal Revenue Code of 1939.

2. Whether an allowance of attorney's fees to an interpleader (the debtor of the taxpayer-assignor) is entitled to priority in the interpleaded fund as against a federal tax lien which had previously attached to the fund.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 3670. PROPERTY SUBJECT TO LIEN.
>
> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
>
> (26 U. S. C., 1952 ed., Sec. 3670.)
>
> SEC. 3671. PERIOD OF LIEN.
>
> Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U. S. C., 1952 ed., Sec. 3671.)

SEC. 3672 [as amended by Sec. 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 505 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien without Notice.*—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under state or territorial laws.*—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office with the State or Territory; or

* * * * *

(26 U. S. C., 1952 ed., Sec. 3672.)

STATEMENT

This action originated in the District Court of Bexar County, 57th Judicial District of Texas, by the filing of a petition of interpleader by R. F. Ball Construction Company, Inc. (one of the respondents herein). Ball's petition was accompanied by a tender of payment into the registry of court of a fund in the amount of $13,228.55 on behalf of Marcus M. Jacobs Company, Inc. (the taxpayer),[1] a creditor of Ball. The peti-

[1] Prior to October 1, 1951, taxpayer company was organized as a partnership. On that date, the partnership incorporated, and the corporation succeeded to all of the rights and liabilities of the partnership. (R. 23-24.) For convenience, both the partnership and the corporation will be referred to as taxpayer.

tion alleged that the suit was one to quiet title to personal property claimed by (among others) the United States and the Union Pacific Insurance Company (the other respondent), both of whom were named as party defendants. The petition also prayed for the allowance to Ball of attorneys' fees of $500 out of the interpleaded fund. (R. 5–6.) On motion of the United States, the case was removed to the United States District Court for the Western District of Texas. (R. 26.)

1. The pertinent facts, as stipulated (R. 2–9) and as found by the District Court (R. 22–28), may be summarized as follows:

On June 26, 1951, Ball entered into a contract with the Housing Authority of the City of San Antonio, Texas, for the construction of a housing project (TEX 6–10). On July 17, 1951, Ball subcontracted a portion of the work to taxpayer, and required of it a performance bond. (R. 22.)

On July 21, 1951, taxpayer applied to the respondent bonding company for a bond payable to Ball, and, as part of the application, assigned to the bonding company, "as collateral security for the full performance of the covenants and agreements herein contained *and the payment of any other indebtedness or liability of the undersigned to the Company, whether heretofore or hereafter incurred*" (emphasis added), all of their right to any sums (both progress payments and retained percentages) which might become due to them under the subcontract with Ball.[2]

[2] Under the terms of the subcontract, Ball was to retain ten per cent of the value of the completed work at all times until Ball's

The bond was executed on July 23, 1951. (R. 22–23.)

On April 4, 1952, taxpayer applied to the bonding company for a similar performance bond payable to the Darby and Perkins Construction Companies covering a subcontract in Louisville, Kentucky. In the application, taxpayer agreed to indemnify the bonding company against all loss which might be incurred as a result of writing the bond. The bond was executed pursuant to the application, and between December 1953 and March 1954 the bonding company, as surety, was required to make payments totalling $12,971.88 on the Kentucky contract. (R. 24.)

The Government's lien for federal withholding and social security taxes assessed against taxpayer arose in March and May of 1953, when the assessment lists were received by the District Director, and notices of these tax liens totalling $17,010.85 were filed in May, June, and September of 1953. (R. 24–25.)

2. In determining the priorities among the parties[3] to the fund paid into court by Ball, the United States District Court held: (1) that Ball (claiming interpleader's attorneys' fees) was entitled to recover the

work had been accepted by the Housing Authority, at which time the ten per cent retained fund would be paid to taxpayer. (R. 23.)

[3] In addition to the claims presented by Ball, the United States, and the bonding company, two claims were presented by Herweck Company, Inc. (a materialman) and S. H. Kottwitz (an unsecured creditor). The Kottwitz company failed to prosecute its claim, and the bonding company agreed to satisfy the Herweck Company claim in the event it should prevail, thus eliminating (under the court's ruling) the necessity for determining the priority of that claim. (R. 13–14.) Default judgments were also entered against other creditors.

sum of $500; (2) that the bonding company (claiming reimbursement for losses sustained in connection with the Kentucky bond) was entitled to recover the remainder of the fund, less court costs; and (3) that the United States (claiming under the tax liens) was not entitled to any recovery [4] (App., *infra*, p. 30).

In a *per curiam* opinion, the Court of Appeals affirmed the judgment of the District Court for the reasons set forth in the latter's opinion (App., *infra*, p. 14).

REASONS FOR GRANTING THE WRIT

The decision below is in direct conflict with the decisions of this Court holding that the relative priority of a federal tax lien is a federal question; that the classes of lienors ("mortgagee, pledge, purchaser, or judgment creditor") protected by Section 3672 of the Internal Revenue Code of 1939 (*supra*, p. 3) are to be defined in the usual and conventional sense of the terms; that the federal tax lien provided by Section 3670 (*supra*, p. 2) is entitled to priority as against inchoate liens not specifically protected by Section 3672; and that the doctrine of relation back cannot operate to destroy the realities of the situation. *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47; *United States* v. *New Britain*, 347 U. S. 81; *United States* v. *Gilbert Associates*, 345 U. S. 361; *United States* v. *Acri*, 348 U. S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U. S. 215; *United States*

[4] It rendered judgment against the Kottwitz and Herweck companies and declared "final" the default judgments previously rendered against various claimants. (R. 30.) See note 3, *supra*.

v. *Scovil*, 348 U. S. 218; *United States* v. *Colotta*, 350 U. S. 808; and *United States* v. *White Bear Brewing Co.*, 350 U. S. 1010.[5] In view of this conflict, and in view of the recurrent character and continuing importance[6] of the problem, a summary reversal of the decision below is, we believe, fully warranted. This, it should be noted, was the disposition in *United States* v. *Colotta, supra,* and *United States* v. *White Bear Brewing Co., supra.*

I. (a) Section 3672 provides that the federal lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector * * *." The Court of Appeals, adopting the District Court's reasoning as its own (App., *infra,* p. 14), concluded that, although the bonding company "could be said" to come within the classification of a "pledgee," it "more nearly" came within the classification of a "'mortgagee' under the Texas law" and "[we] therefore hold that the Bonding Company under its assignment as collateral security became a 'mortgagee' within the meaning of [Section] 3672 * * *"[7] (App., *infra,* pp. 21, 23). Thus,

[5] It is also in conflict with *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C. A. 2d); and *Aetna Casualty & Surety Co.* v. *Horticultural Service*, 1 Misc. 2d 956, reversed on other grounds, 158 N. Y. S. 2d 750.

[6] While the federal liens here involved arose under Sections 3670, 3671, and 3672 of the Internal Revenue Code of 1939, the Internal Revenue Code of 1954 reenacts these provisions without changes material here. See Sections 6321, 6322, and 6323 of the 1954 Code; H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A406–A407; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 575–576.

[7] With respect to the "purchaser" category in Section 3672, the District Court stated (App., *infra,* p. 20): "* * * I do not rest my

on the basis of the 1951 assignment, the Court of Appeals sustained the bonding company's claim to priority of payment from the interpleaded fund as against the lien of the United States.

The assignment in question was executed in connection with the issuance of a bond pertaining to a building contract to be performed by the taxpayer in Texas. It was executed some nine months prior to issuance of another bond pertaining to a wholly separate building contract to be performed by the taxpayer in Kentucky. Taxpayer defaulted under the Kentucky contract, and about two and a half years after execution of the Texas bond the bonding company was required to make payments under the bond relating to the Kentucky contract. The bonding company then sought repayment on the basis of the taxpayer's 1951 assignment made in connection with the Texas bond. This assignment, after reciting that all sums which might become due taxpayer under the Texas contract were assigned to the bonding company for the full performance of the covenants and agreements therein contained, further recited that such sums were also assigned "as collateral security for * * * the payment of any other indebtedness or liability of the undersigned [taxpayer] to the Company, whether heretofore or hereafter incurred." (R. 22–23.)

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decision on this ground since, in the Scovil case [*supra*] the Supreme Court said: 'A purchaser within the meaning of Section 3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee.'" No claim has ever been made that the bonding company falls within the "judgment creditor" category.

This clause, it should be noted, was in no way limited by time, amount, or transaction. At the time of the assignment, not only was the amount assigned (*i. e.*, the account receivable on the Texas contract) neither fixed nor earned, but the contingency on which the assignment depended (*i. e.*, the taxpayer's indebtedness to the bonding company) had not yet arisen. In fact, at that time, it was not known whether there would ever be any indebtedness such as subsequently materialized and, if so, what the amount would be; such indebtedness could hardly even have been contemplated since the bond on the Kentucky contract was not executed until some nine months after the bond on the Texas contract. Several months before the indebtedness materialized in connection with the Kentucky contract, the federal tax liens arose and were duly recorded.

Contrary to the decision below, the assignment does not constitute a "mortgage" (or "pledge") within the meaning of Section 3672. As this Court said (p. 88) in the *New Britain* case, *supra*, which also involved a claim based on the "mortgagee" clause, there is nothing in the language of Section 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein.[8] And those specific categories are to be defined in their usual and conventional sense and in a uniform manner in all the states. See *United States* v. *Gilbert Associates*, 345

[8] See also the concurring opinion of Mr. Justice Jackson in *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47, 52, cited in both *Gilbert* (p. 364) and *Scovil* (p. 220).

U. S. 361, 364 ("judgment creditor"); *United States* v. *Scovil*, 348 U. S. 218, 220–221 ("purchaser"). Under that standard, in order to qualify as a "mortgage" (or "pledge") for purposes of Section 3672, surely an assignment to secure an indebtedness must—at the very least—relate to an *existing* indebtedness, not merely an indebtedness that might arise in the future. Here, as already pointed out, the indebtedness secured by the assignment did not come into existence until long after the federal liens were perfected. If such an assignment were to be considered as a "mortgage" (or "pledge") under Section 3672, it is apparent that a taxpayer, by the simple expedient of assigning accounts receivable to another to secure a future indebtedness that may never materialize, could easily thwart the Government in the collection of its taxes.

(b) Adverse liens far more specific and choate than the bonding company's interest here have repeatedly been held by this Court to be subordinate to perfected federal tax liens, even where the adverse liens first arose prior to the federal liens. *Security Tr. & Sav. Bk.* case, *supra* (statutory attachment lien); *Acri* case, *supra* (statutory attachment lien); *Liverpool & London* case, *supra* (statutory garnishment lien); *Scovil* case, *supra* (statutory landlord's distress lien); *Colotta* case, *supra* (statutory mechanic's lien); *White Bear* case, *supra* (statutory mechanic's lien). The courts below sought to distinguish these decisions on the ground that the liens involved there

"arose by virtue of some statutory right, not specifically referred to in Section 3672." But this distinction is based on a misconception of the function of Section 3672. It was not designed to make any exception to the usual rule that a perfected federal tax lien is entitled to priority as against an inchoate lien. Instead, Section 3672 is merely a recordation statute enacted to put lenders, etc., on notice of the federal lien. See *Security Tr. & Sav. Bk.* case, 340 U. S. at 51–53 (concurring opinion). Apart from this notice requirement, there is no basis for assuming that Congress, in enacting Section 3672, intended different priority standards to apply to the designated non-statutory liens than to statutory liens. Thus, the statute would not protect even a true "mortgagee" as to advances made *after* recording of the federal lien.

In this case, the advances for which the bonding company seeks "mortgagee" status were not made until several months after the federal liens had been recorded. Prior to the recording of the federal liens, there was at most a mere possibility that the taxpayer might become indebted to the bonding company. Such a mere possibility is plainly insufficient to constitute a specific and choate lien under this Court's decisions (*supra*). For like reasons, such a mere possibility is insufficient to entitle the bonding company to the status of a "mortgagee" under Section 3672. And, even assuming *arguendo* that the 1951 assignment matured into a "mortgage" (or "pledge") in December 1953 and March 1954 when the bonding company

made its advances, this Court's decisions have also made it clear that the doctrine of relation back will not be permitted to destroy the realities of the situation. See, *e. g.*, the *Security Tr. & Sav. Bk.* case, *supra*, p. 50.

In short, the bonding company is not entitled to "mortgagee" (or "pledgee") status under Section 3672, not only (a) because the assignment on which it relies is not a "mortgage" (or "pledge") within the usual and conventional meaning of the term, but also (b) because the "lien" created by the assignment was unspecific and inchoate at the time the federal tax liens were perfected.

2. A subsidiary question presented in this case is whether the court below properly allowed a fee for the services of the interpleader's attorney to be paid out of the fund impressed with the federal tax lien.[9]

In holding that the fee was allowable, the courts below sought to distinguish the decision of this Court in *United States* v. *Liverpool & London Ins. Co.*, 348 U. S. 215, on the ground that the attorney's fee involved in the *Liverpool* case related to a garnishment suit, not an interpleader action (App., *infra*, pp. 14, 24).

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[9] It is to be noted that the interpleaded fund involved here exceeds the amount claimed by the bonding company, and hence that, even if the bonding company's claim were entitled to priority (as the courts below held), over half of the fund awarded to the interpleader's attorneys was at the expense of the Government.

[10] The case of *United States* v. *Ullman*, 115 F. Supp. 211 (E. D. Pa.), which the court below followed, was decided prior to this Court's decision in the *Liverpool* case; moreover, the *Ullman* case is not "directly in point," as was held below (R. 21), since there the United States had instituted the suit to foreclose its income tax liens. The *Ullman* case is distinguished in *Ford Motor Co.* v. *Hackart Construction Co.*, 143 F. Supp. 216 (N. J.), wherein it

Irrespective of the validity of such a distinction, the fact is that this Court in *Liverpool* characterized the proceeding in that case as an "interpleader action" (p. 216). Moreover, in *Liverpool* as here, the "interpleader action" had been removed from a Texas state court to a United States District Court (*ibid.*). In *Liverpool*, this Court concluded (p. 217) that "* * * certainly fees allowed in that proceeding are not prior to the Government liens, and the authorization of the payment of the attorney's fees prior to the Government liens was error." That holding is plainly controlling here.

CONCLUSION

The questions presented have already been authoritatively settled by this Court in a series of recent decisions. Under those decisions, the decision below is clearly erroneous. It is therefore respectfully submitted that the petition for a writ of certiorari should be granted and the judgment reversed without further briefs or argument.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

A. F. PRESCOTT,
GEORGE F. LYNCH,
Attorneys.

APRIL 1957.

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is pointed out that the decision in the *Ullman* case did not purport to resolve a conflict between a Government lien and an allowance of fees since the question of priorities of interest in the interpleaded fund had not been reached. The decision of this Court in the *Liverpool* case was also followed in *Bruce* v. *United States*, 127 F. Supp. 858 (E. D. Mich.), and *Boston Insurance Co.* v. *Stubbs* (W. D. Wash.), decided March 20, 1956 (1956 C. C. H., par. 9695).

APPENDIX

In The United States Court of Appeals for the Fifth Circuit

No. 16276

UNITED STATES OF AMERICA, APPELLANT

v.

R. F. BALL CONSTRUCTION COMPANY, INC., AND UNITED PACIFIC INSURANCE COMPANY, APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS.

(December 26, 1956)

Before CAMERON, JONES and BROWN, Circuit Judges.

Per curiam: The facts of this case are well recited and the controlling principles of law are well stated in the opinion of Judge Rice, *R. F. Ball Construction Company v. Jacobs,* 140 F. Supp. 60. For the reasons there set forth the judgment appealed from is

Affirmed.

JUDGMENT

Extract from the Minutes of December 26, 1956.

[Caption omitted.]

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the

said District Court appealed from in this cause be, and the same is hereby, affirmed.

United States District Court, Western District of Texas, San Antonio Division

Civil action No. 1997

R. F. BALL CONSTRUCTION COMPANY, INC., PLAINTIFF

vs.

MARCUS M. JACOBS AND HENRY LESKY, d/b/a MARCUS M. JACOBS CO., ET AL., DEFENDANTS

MEMORANDUM OF DECISION

Pursuant to Rule 52 (a) this Memorandum of Decison is filed and contains findings of fact and conclusions of law in this case, the facts of which have all been stipulated by the parties.

On June 26, 1951, R. F. Ball Construction Company (hereinafter called Ball) entered into a contract with the Housing Authority of the City of San Antonio (hereinafter called Housing Authority) for the construction of a housing project. Shortly thereafter Ball subcontracted the painting and decorating involved in such contract to Marcus M. Jacobs Company, a co-partnership consisting of Marcus Jacobs and Henry Leskey [sic] (hereinafter called Jacobs) for the sum of approximately $230,000.00 and required of it a faithful performance bond. On July 21, 1951, Jacobs applied to United Pacific Insurance Company (hereinafter called Bonding Company) for such performance bond, and one of the considerations agreed to in the application for such bond was an unconditional assignment by Jacobs to the Bonding Company of all percentages retained by Ball under the Jacobs subcontract as collateral security for the protection of

the Bonding Company, not only for losses growing out of the Housing job, but for the "payment of any other indebtedness or liability" of Jacobs to the Bonding Company, "whether heretofore or hereafter incurred". A few months thereafter the business of Jacobs was incorporated into Marcus M. Jacobs Company, Inc. (hereinafter called Jacobs, Inc.) and the corporation succeeded to all rights and liabilities of the partnership. No party to this controversy has raised any question about the succession, so this mutation from the partnership to the corporation is immaterial and will not be referred to further. See *Miles* v. *Aetna*, 1 F. Supp. 925; *Illinois Surety Co.* v. *Davis*, 244 U. S. 376, 37 S. Ct. 614, 61 L. Ed. 1202.

Thereafter, on April 4, 1952, Jacobs, Inc. obtained from the Bonding Company a similar bond on another sub-contract in Louisville, Kentucky, in the application for which Jacobs, Inc. agreed "to indemnify and keep indemnified the company against all loss, costs, damages, expenses and attorney's fees whatsoever * * *", and under such bond the Bonding Company exposed itself to a liability of some $35,000.00.

On April 30, 1953, the Housing Authority accepted the work of Ball and subsequently it was agreed between Ball and Jacobs, Inc. that the sum of $13,228.55 representing the retained percentages according to the terms of the sub-contract, was due and owing on this job by Ball to Jacobs, Inc., as of April 30, 1953.

In May, June and September of 1953, and long after the assignment as collateral security of the retained percentages on the Housing Authority job had been made to the Bonding Company, and long after the Bonding Company had executed its obligation under its bond on the Louisville job, the United States Government filed tax liens against Jacobs, Inc. totalling $17,010.85. No stipulation is made by the parties that

this tax claim arose out of Jacobs, Inc.'s failure to pay taxes incurred on either the Housing Authority job or the Louisville job, so that this court must assume that they are ordinary tax liens, not growing out of the particular jobs in question, and the Government here makes no claim on either of the bonds.

After the tax liens had been filed, the potential liability on the Kentucky job incurred by the Bonding Company on April 4, 1952, became an actual liability and the Bonding Company was required to pay, by virtue of its bond in connection with the Kentucky project, the sum of $12,971.88.

Thereafter, because of numerous conflicting claims presented to Ball, Ball was unable to determine with safety to itself to whom the $13,228.55 of retained percentages which it held in its hands should be paid. Therefore, Ball filed this suit, which is an interpleader action, making as parties defendant Jacobs and Jacobs, Inc., the Government, the bonding Company and certain suppliers of materials and services on the Housing Authority job, and asking for an interpleader's fee of $500.00, which has been stipulated to be a reasonable fee if under the law any interpleader's fee is payable. The Government filed its answer claiming the funds by virtue of its tax liens; the Bonding Company filed its answer claiming $12,971.88 of the funds by virtue of its assignment as collateral security and the loss which it sustained on the Kentucky job; the Herweck Company, Inc. filed its claim for $981.83 for materials furnished on the Housing job; S. H. Kottwitz & Company filed its claim for compensation and public liability insurance premiums on said job of $2,431.05. Several other claimants were made parties defendant but failed to answer and make claim, and default judgment was rendered against them. Kottwitz, although filing a claim, has not appeared in any

of the hearings, and has failed to file any briefs herein in support of his claim; and it appearing to the court that under decision such as *U. S.* v. *Yates,* 204 S. W. 2d 399, as well as by virtue of default, Kottwitz is not entitled to recover, judgment will go against him.

The Herweck Company has filed its brief contending that it is entitled to priority, but has likewise stated that the Bonding Company had agreed to satisfy its claim if the Bonding Company prevailed herein, and has asked, therefore, that judgment go in favor of the Bonding Company, and in view of this Herweck likewise goes out of the case, under the court's rulings, since the court is of the opinion that the Bonding Company should prevail herein, and will respect the agreement between Herweck and the Bonding Company.

The principal question for determination by this court is as to which lien is prior—the Government's tax lien which arose by virtue of the filing of the notice of its tax liens in May, June and September of 1953, or the contract lien of the Bonding Company which arose long prior thereto by virtue of the assignment of the retained percentages in question by Jacobs to the Bonding Company, which by contract protected the Bonding Company from the loss which it incurred on the Louisville job, which became a potential loss upon the execution of the Louisville bond on April 4, 1952, prior to the filing of the Government's tax liens, but which was not paid under its bond until after the filing of the Government's tax liens.

The Government cites and contends that the case of *U. S.* v. *Security Trust & Savings Bank,* 340 U. S. 47, 71 S. Ct. 111; *U. S.* v. *Gilbert Associates,* 345 U. S. 361, 73 S. Ct. 701; *U. S.* v. *City of New Britain,* 347 U. S. 81, 74 S. Ct. 367; *U. S.* v. *Acri,* 348 U. S.

211, 75 S. Ct. 239; *U. S.* v. *Liverpool, etc. Ins. Co.*, 348 U. S. 215, 75 S. Ct. 247; and *U. S.* v. *Scovil*, 348 U. S. 218, 75 S. Ct. 244, are in point and are controlling in this case, and says:

> "* * * the principles of *United States* v. *Security Trust & Sav. Bk.*; *United States* v. *New Britain*; *United States* v. *Scovil*; *United States* v. *Acri*; and *United States* v. *Liverpool & London Ins. Co.*, supra, must be applied."

The Bonding Company, on the other hand, contends that none of the liens in the above cited cases were contractual liens and that none of those cases dealt with mortgagees, pledgees, or purchasers within the meaning of Section 3672 of the Internal Revenue Code (now Sec. 6323, Title 26 U. S. C.), and further contends that in those cases the court was construing only the term "judgment creditor" and liens other than mortgages and pledges, and therefore says that such cases are not controlling in this case.

Section 3672 of the Internal Revenue Code provides in effect that filing of a federal tax lien does not affect the rights of any prior "mortgagee, pledgee, purchaser or judgment creditor". Most of the decisions of the Supreme Court cited above and referred to by the Government dealt with inchoate judgment liens and none of those cases dealt with the contract lien of a "mortgagee", "pledgee" or "purchaser". The latter three categories are all based upon a contract right of some sort, whereas the term "judgment creditor" and the other liens dealt with in those cases, such as water rent liens, municipal tax liens and landlord's distress liens, arose by virtue of some statutory right, not specifically referred to in Section 3672.

The Bonding Company contends that since its assignment as collateral security was based upon a contract which was prior in time to the Government's tax

lien, it is either a mortgagee, pledgee or purchaser of the retained funds and it disclaims any contention on its part that it is a judgment creditor, or claims to be anything other than a mortgagee, pledgee or purchaser.

In the case of *National Refining Co.* v. *U. S.*, 106 F. 2d 951, the taxpayer was indebted to National Refining Company, which took an assignment as collateral security from the taxpayer of certain commissions to be earned by him under his contract with the Government "when they should become available to him". Before any money had been earned or paid under this assignment, the Government perfected a tax lien and there claimed that the assignment as collateral security was subordinate. In holding that the assignment to the National Refining Company took priority over the Government's tax claim, the court said:

> "We think it safe to say that one who for a valuable present consideration acquires a property or interest in property, is 'a purchaser' within the meaning of 26 U. S. C. A. Internal Revenue Code, Section 3672."

It cannot be doubted that the execution by the Bonding Company of the bonds in this instance constituted "a valuable present consideration" and it further cannot be doubted that at the time of the assignment as collateral security of the retained percentages by Jacobs to the Bonding Company, the Bonding Company acquired an interest in these retained percentages. However, I do not rest my decision on this ground since in the *Scovil* case the Supreme Court said: "A purchaser within the meaning of Sec. 3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee".

In the case of *Knight* v. *Knight*, 71 N. Y. Supp. 2d 357, the Government claimed that its lien for federal

taxes was superior to a prior assignment of future wages as collateral security for payments to the taxpayer's divorced wife. The court there held:

> "The Government attempts to avoid the impact of Section 3672 by contending that respondent is not a pledgee. We think that as the assignment of wages made by defendant Knight was as security for, and a mean of payment of, the defendant's principal obligation to pay plaintiff $20,000.00, the plaintiff comes within the classification of a pledgee."

This case was subsequently affirmed by the Court of Appeals, 80 N. E. 2d 344, and was not appealed by the Government to the Supreme Court of the United States.

The assignment of retained percentages in the case at bar was made by Jacobs as security for and a means of payment of Jacob's obligation to idemnify the Bonding Company against loss, and it could be said therefore, as was held in the *Knight* case, that the Bonding Company "comes within the classification of a pledgee."

In my opinion, however, the Bonding Company in this instance more nearly comes within the classification of a "mortgagee" under the Texas law, which "should be given considerable weight in determining whether or not" the Bonding Company is a mortgagee. See *U. S.* v. *Gargill,* 218 F. 2d 556 at 560. According to 29 Tex. Jur. 786,

> "A mortgage, in the broadest sense of the term, is a pledge of property, either real or personal, or of a chose in action, as security for the performance of an obligation."

According to 29 Tex. Jur. 838,

> "A mortgage which purports to secure future debts is not ineffectual or invalid. On the contrary the lien created will be enforced not only

> in a dispute between the mortgagor and mortgagee but also in a controversy involving the rights of one who claims under the mortgagor."

As was recently stated by the Supreme Court of Iowa in *Evans* v. *Stewart*, 66 N.W. 2d 442 at 449:

> "We feel the requirement that the lienholder be a 'mortgagee' is a requirement of status—that he be in the position of one holding a mortgage."

It is true that the parties to the assignment as collateral security in this instance did not place a label on this transaction as either a mortgage, a pledge or a purchase, but courts do not decide cases on nomenclature; they look to the substance of the transaction; and the substance of the assignment here was to put the Bonding Company in the status of either a mortgagee, pledgee or purchaser, and therefore Section 3672 applies.

In *Northern Nat. Bank* v. *Northern Minn. Nat. Bank*, 70 N. W. 2d 118, the Supreme Court of Minnesota held that an assignment as security of retained percentages under a construction contract to a bank which was prior in time to a Federal tax lien, was superior to the claim of the Government, which is precisely the situation here. The Government did not appeal that case to the Supreme Court of the United States.

The distinction between a contract lien and a statutory lien is made clear by comparing the case of *Evans* v. *Stewart*, supra, with the *Scovil* case, supra. In the *Scovil* case, the Supreme Court held that prior to the time it ripened into a final judgment, an incompleted statutory, landlord's lien was inferior to a federal tax lien, since the holder thereof was neither a "mortgagee", "pledgee", "purchaser" nor "judgment creditor". In the *Evans* case, the court held that a written

contract landlord's lien contained in the lease was superior to a federal tax lien because it was a "mortgage" within 3672. The Government did not appeal the *Evans* case.

The Government argues that if an attachment or other judicial lien is not sufficiently "choate" or complete "to defeat a subsequent tax lien" then a mortgage to secure future indebtedness should likewise be inferior to a subsequent tax lien. Congress has in effect stated in Sec. 3672 that before an attaching, or other similar statutory lien or, could claim priority over the Government, his claim had to ripen into a final judgment. *U. S.* v. *Security Trust, etc.,* supra. *U. S.* v. *Acri,* supra. No such qualification was placed by Congress on the contractual lien of a "mortgagee". It is the Congress which enacts the law with reference to priorities and not the courts, and I therefore hold that the Bonding Company under its assignment as collateral security, became a "mortgagee" within the meaning of 3672 and was, therefore, not affected by the tax liens which were subsequent in time.

While admitting that "the Government does not claim the status of an innocent purchaser for value", the Government does contend that because the Bonding Company did not record its assignment under the provisions of Article 260–1, R. C. S. of Texas, said assignment is therefore inferior to the claim of the Government. In Texas, the recording of an assignment adds nothing to the validity thereof as between the parties. (9 Tex. Jur. 97.)

As I see it, the Government is seeking to read into Section 3672 provisions which Congress has not seen fit to insert therein and the Government would have this court construe such section to read:

> "Such lien shall not be valid as against any mortgagee *whose mortgage is due at a certain*

time and in a certain amount and which mortgage has been duly recorded in accordance with law."

Had Congress seen fit to make such a requirement it could have done so, but I decline to read these words into the statute, and on this point I concur in the opinion of Judge Wyche in the case of *U. S. v. Anders Contracting Company,* 111 F. Supp. 700, where the Government made identically this same contention, was overruled, and did not appeal.

There remains for consideration the question as to whether or not Ball is entitled to any interpleader's fee in this case. The Bonding Company has raised no objection to awarding such fee and in fact has presented cogent arguments as to why such fee should be allowed. The Government, on the other hand, contends that under the case of *U.S. v. Liverpool, etc.,* supra, the interpleader is not entitled to his costs. There can be no question as to the status of Ball in this matter. Ball was an innocent stakeholder confronted with conflicting claims to a fund which was in his hands, and he adopted the proper course of employing attorneys and tendering this money into court. As was said by the Supreme Court in its opinion therein, the *Liverpool* case had to do solely with a garnishee's fee under Rule 677 of the Texas Rules of Civil Procedure and did not purport to deal with an Interpleader action under Texas Rule 43 or Rule 22 of the Federal Rules of Civil Procedure, and it is therefore not controlling. On the other hand, the case of *U. S.* v. *Ullman,* 115 F. Supp. 211, is directly in point, and I adopt the reasoning of the court in that case and hold that Ball is entitled to his interpleader's fee in this case, and the remainder of the interpleaded fund, less costs, should be awarded to the Bonding Company.

The attorneys for the Bonding Company are directed to submit a judgment not inconsistent with this Memorandum.

Done on this 29th day of March A. D. 1956.

(s) BEN H. RICE, JR.
Chief Judge,
United States District Court,
Western District of Texas.

Filed: April 17, 1956.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(Title Omitted)

FINDINGS OF FACT

1. On June 26, 1951, R. F. Ball Construction Company, Inc. (hereinafter referred to as Ball) entered into a contract with the Housing Authority of the City of San Antonio, Texas, for the construction of Housing Project TEX 6–10.

2. On July 17, 1951, Ball subcontracted the painting and decorating, taping and floating of sheetrock and waterproofing of masonry units on the Housing Project to Marcus M. Jacobs and Henry Lesky, d/b/a Marcus M. Jacobs Co.

3. As a part of the subcontract, Jacobs and Lesky agreed:

> * * * to furnish and pay for all labor, material, tools, equipment, compensation insurance and public liability and property damage insurance (carried in responsible companies and in limits satisfactory to R. F. Ball Construction Company, Inc.), also keep records and make payments on all Federal and/or State Payroll Taxes and/or deductions, together with all other incidentals necessary to complete in a good and workmanlike manner (the subcontracted work) * * *

4. On July 21, 1951, Jacobs and Lesky applied to United Pacific Insurance Company for a faithful performance bond, payable to Ball, in the penal sum of $229,029. The application contained the following clause:

> the undersigned does by these presents assign, transfer and convey to United Pacific Insurance Company, the Company, as of this date, as collateral security for the full performance of the covenants and agreements herein contained and the payment of any other indebtedness or liability of the undersigned to the Company, whether heretofore or hereafter incurred the following:
>
> * * * * *
>
> (d) All right, title and interest of the undersigned in and to and all percentages retained by the Obligee under said contract, and any and all estimates, payments, extras, final payments, and other sums that . . . may be due or may thereafter become due under said contract to or on behalf of the undersigned.

5. On July 23, 1951, Jacobs and Lesky (as principals) and United Pacific (as surety) executed a bond in the amount of $229,029, with Ball as obligee, conditioned upon the faithful performance of the Housing Project subcontract "according to its terms, covenants, and conditions".

6. Under the terms of the subcontract, Ball was to retain 10% of the value of the completed work at all times until Ball's work had been accepted by the Housing Authority, at which time the 10% retained fund would be paid to Jacobs and Lesky.

7. On October 1, 1951, Jacobs and Lesky incorporated their business under the name of Marcus M. Jacobs Company, Inc. and the corporation succeeded to all of the partnership's rights in the Housing Project subcontract. Jacobs' and Lesky's contractual

obligations under the application for the performance bond were binding upon their successors and assigns, which includes the corporation.

8. On April 4, 1952, Marcus M. Jacobs Company, Inc. applied to United Pacific Insurance Company for a bond in the amount of $35,591 payable to the Darby and Perkins Construction Companies covering a subcontract in Louisville, Kentucky. In this application, the corporation agreed to indemnify United Pacific against all loss (including expenses and attorneys' fees) which might be incurred as a result of writing the bond.

9. Pursuant to the application, United Pacific (as surety) and the corporation (as principal) executed a bond and, between December of 1953 and March of 1954, United Pacific, as surety under the bond, was required to make payments totaling $12,971.88.

10. On April 30, 1953, the Housing Authority accepted Ball's work and, pursuant to the subcontract, $13,228.55 (representing the 10% retained by Ball) became due and owing to Marcus Jacobs Company, Inc.

11. The following table sets forth the pertinent information with respect to Marcus Jacobs Company, Inc.'s tax liabilities to the United States:

Kind of tax	Taxable period	Date assessment list received by district director	Date Notice of Tax Liens Filed	Outstanding Balance
W-H	4 Q. '52	3/16/53	6/ 9/53	$6,343.24
FUTA	1952	5/14/53	9/ 5/53	1,012.47
FICA	1 Q. '53	5/15/53	5/18/53	9,655.14
				$17,010.85

12. On July 13, 1953, Herweck Company, Inc. notified United Pacific, the Housing Authority, and Ball that it had a claim against Marcus Jacobs Company, Inc. for $981.83 as a result of paint and other materials furnished in connection with the performance of the subcontract.

13. On September 18, 1953, S. H. Kottwitz & Company notified Ball and United Pacific that it had a claim against Marcus Jacobs Company, Inc. for unpaid insurance premiums in the amount of $2,431.05.

14. On May 24, 1954, Ball commenced this action as an interpleader suit, tendering the $13,228.55 which it owed to Marcus Jacobs Co., Inc., into the registry of the District Court of Bexar County, Texas, asking interpleader's attorneys' fees and costs, to be paid out of the fund. It is agreed between the parties that, if Ball is entitled to receive an interpleader's attorneys' fee as a matter of law, a reasonable sum would be $500.

15. The following parties were named defendants:

Marcus M. Jacobs and Henry Lesky, individually and as partners, d/b/a Marcus M. Jacobs Co.
Marcus M. Jacobs Co., Inc.
United Pacific Insurance Company
Herweck Company, Inc.
Otto Dukes, d/b/a Otto Dukes Machinery Company
Floor Maintenance Bureau Products Company (a corporation)
J. T. Dulaney and R. T. Dulaney, partners, d/b/a Dulaney Service Company
S. H. Kottwitz & Company
The United States of America
R. L. Phinney, District Director of Internal Revenue.

16. The United States of America removed the case to this Court on June 15, 1954, and the $13,228.55

deposited by Ball in the registry of the State Court is now in the registry of this Court.

17. R. L. Phinney, District Director of Internal Revenue, was dismissed as a party.

18. On October 21, 1954, default judgments were entered against the following parties:

Marcus M. Jacobs and Henry Lesky, individually and as partners, d/b/a Marcus M. Jacobs Co.
Marcus Jacobs Co., Inc.
Otto Dukes, d/b/a Otto Dukes Machinery Company
Floor Maintenance Bureau Products Company (a corporation)
J. T. Dulaney and R. T. Dulaney, partners, d/b/a Dulaney Service Company.

19. The remaining parties (Ball, United Pacific, Herweck, Kottwitz, and the United States) submitted the case on a stipulation of facts.

20. The Court must decide what are the relative priorities of the following creditors with respect to the $13,228.55 now on deposit in the registry of this Court representing the retained fund owed by Ball to Marcus Jacobs Co., Inc. as a result of performance of the subcontract on the TEX 6–10 Housing Project:

(a) The United States of America (claiming under tax liens against all property and rights to property belonging to Marcus Jacobs Co., Inc.).

(b) United Pacific Insurance Company (claiming reimbursement for losses sustained as a result of the Louisville bond as assignee of the retained fund earned by Marcus Jacobs Co., Inc. in performing the TEX 6–10 Housing Project subcontract).

(c) Herweck Company, Inc. (an unpaid material man).

(d) S. H. Kottwitz & Company (holding a claim for unpaid insurance premiums).

(e) R. F. Ball Construction Company, Inc. (claiming interpleader's attorneys' fees).

CONCLUSIONS OF LAW

1. Herweck Company, Inc., has not shown that it has any lien on the retained fund in question, as such. Therefore, the claim of Herweck Company, Inc. will be considered an unsecured claim so far as this fund is concerned.

2. S. H. Kottwitz & Company has not shown that it has any lien on the retained fund in question. Therefore, the claim of S. H. Kottwitz & Company will be considered an unsecured claim so far as this fund is concerned.

3. R. F. Ball Construction Company, Inc. under the usual rule, is entitled to interpleader's attorneys' fees out of the fund in question and the parties have stipulated that a reasonable fee in this case is $500. Ball's right to this fee is superior to the tax liens asserted by the United States and to the claim of United Pacific Insurance Company and, therefore, Ball is entitled to receive $500 out of the $13,228.55 now on deposit in the registry of the Court.

4. As between the tax liens asserted by the United States and the assignment claimed by United Pacific Insurance Company, the assignment gave United Pacific an interest in the retained fund which is superior to the Government's tax liens. United Pacific's claim totals $12,971.88 plus expenses and attorneys' fees in connection with the loss sustained under the Louisville bond. United Pacific is therefore entitled to receive the balance of the $13,228.55 on deposit in the registry of the Court after the payment of $500 to Ball and costs.

Done at the request of the government on this 14th day of April, 1956.

(s) BEN H. RICE, JR.
Chief Judge,
United States District Court,
Western District of Texas.

Filed: April 17, 1956.

U. S. GOVERNMENT PRINTING OFFICE: 1957